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IN THE

Supreme Court of the United States

October Term, 1967
No. 1389

ADOLPH WEINBERG and ETTA WEINBERG,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

DEMETRIOU & DEL GUERCIO,
RICHARD A. DEL GUERCIO,
RONALD J. DEL GUERCIO,
612 South Flower Street,
Los Angeles, Calif. 90017,
Attorneys for Petitioners.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

SUBJECT INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes and Regulations Involved in the Case	3
Concise Statement of the Case	4
Reasons for Granting Petition for Writ of Certiorari	10
I.	
The Court of Appeals Failed to Accord Petitioners the Proper Standard of Appellate Review and Thus Perpetuated the Errors of the Tax Court	10
A. The Tax Court Finding of the Ultimate Fact of Transfer of Cash Proceeds as Distinguished From Farm Crops Is Required to Be Reviewed Free From the Restraints of the "Clearly Erroneous Rule"	13
B. Whether the Petitioners Transferred Crops or Cash Is an Ultimate Finding Involving Questions of Law or Mixed Questions of Law and Fact	14
II.	
The Law of the State of California Compels the Ultimate Finding That Farm Crops Were Transferred	17

III. Page

The Tax Court Erred in Concluding That Farm Crops Had Not Been Transferred When the Notice of Deficiency and a Stipulation Established That Farm Crops Were Transferred 23

IV.

The Tax Court Erred in Its Alternative Decision That, Assuming That Farm Crops Were Transferred, the Petitioners Transferred Income Already Earned by Describing the Transaction as an Anticipatory Assignment of Income 28

Conclusion 35

INDEX TO APPENDICES

Page

Appendix A. Opinion of the United States Court of Appeals for the Ninth Circuit 1

Appendix B. Opinion of Tax Court, 44 T.C. No. 26 2

Appendix C. Report of Commissioner to the Chief Judge of the Tax Court of the United States 26

Appendix D. Judgment 39

Appendix E. Internal Revenue Code of 1954, Section 351 (a) 40

Appendix F. Tax Court Rules of Practice, Rule 31 (b) 41

Appendix G. Commissioner's Notice of Deficiency.. 42

TABLE OF AUTHORITIES CITED

Cases	Page
Anderson v. Comm'r, 78 F. 2d 636	15
Baumgartner v. United States, 322 U.S. 665, 64 S. Ct. 1240, 88 L. Ed. 1525	13
Blair v. Comm'r, 300 U.S. 5, 57 S. Ct. 330	14, 30, 31
Brown v. Cowden Livestock, 187 F. 2d 1015	15
Burnet, Tom L., Estate of, 2 T.C. 89	31
Campbell v. Prothro, 209 F. 2d 331	32
Campbell, Vincent C., 11 T.C. 510	24
Carey v. Glenco Citrus Products Co., 45 Cal. Rptr. 365, 235 Cal. App. 2d 727	17
Comm'r v. South Lake Farms, Inc., 324 F. 2d 837	31, 32
Cordovan Associates, Incorporated v. Dayton Rubber Company, 290 F. 2d 858	25
Davis v. Parkhill-Goodloe, 302 F. 2d 489	12
Fulton National Bank, 363 F. 2d 562	27
General Utilities & Operating Co. v. Helvering, 296 U.S. 200, 56 S. Ct. 185	24
Gensinger v. Comm'r, 208 F. 2d 576	22, 32, 34
Hamilton v. Klinke, 42 Cal. App. 426, 183 Pac. 675	20
Hatch v. Standard Oil Company of Cleveland, 100 U.S. 554, 25 L. Ed. 124	22
Heringer v. Comm'r, 235 F. 2d 149	29
Hersloff et al. v. U.S., 310 F. 2d 947	33
Jones v. California Growers & Shippers, 182 Cal. 777, 190 Pac. 172	17

Page

Lewis v. Farmers Grain & Milling Co., 52 Cal. App. 211, 198 Pac. 426 16

Louisiana Irrigation & Mill Co., 14 T.C.M. 1252 .. 31

Lund v. Ganahl, 22 Cal. App. 103, 133 Pac. 501 .. 19

Mamiye Bros. v. Barber Steamship Lines, Inc., 360 F. 2d 774 13

Nash, Aubrey S., 31 T.C. 569 24

Nead v. Specimen Hill Mining Co., 52 Cal. App. 2d 475, 126 P. 2d 450 17

Norfolk Nat'l Bank of C & T v. Comm'r, 66 F. 2d 48 25

Pacific Grape Products Co. v. Comm'r, 219 F. 2d 862 17

Pearce v. Comm'r, 315 U.S. 543, 62 S. Ct. 754 .. .. 14, 30, 31

Plomb Tool Co. v. Sanger, 193 F. 2d 260 12

Portland Oil Co. v. Comm'r, 109 F. 2d 479, cert. den. 310 U.S. 650, 60 S. Ct. 1100 29

Post v. Jacobsen, 4 Cal. Rptr. 817, 180 Cal. App. 2d 297 17

Rodgers, Stuart A., 38 T.C. 785 31

Romine, Ralph, 25 T.C. 859 31

Shatzer, Catharine G., 3 T.C. 914 31

Simon v. Comm'r, 285 F. 2d 422 14

Sorelle, Elsie, 22 T.C. 459 31

Stevenot v. Norberg, 210 F. 2d 615 16

United States v. General Motors Corporation, 384 U.S. 127, 16 L. Ed. 2d 415, 86 S. Ct. 1321 14

Page

United States v. Horschel, 205 F. 2d 646 .....31, 32, 33

United States v. Singer Mfg. Co., 374 U.S. 174, 83 S. Ct. 1773, 10 L. Ed. 2d 823 14

Universal Camera Corporation v. National L.R. Bd., 340 U.S. 474, 95 L. Ed. 456, 71 S. Ct. 456 13

Weaver v. Comm'r, 58 F. 2d 755 23

Wellhouse, Jr., et al. v. Tomlinson, 197 F. Supp. 739 .....33, 34

White v. Brodrick, 104 F. Supp. 213 app. dis. 198 F. 2d 751 .....32, 34

Wilson, Thomas, 25 T.C. 1058 26

Regulations

Treasury Regulations of 1954, Par 1,118-1 29

Rules

Tax Court Rules of Practice, Rule 31(b)(1) 4, 23

Tax Court Rules of Practice, Rule 31(b)(4) 4, 23

Tax Court Rules of Practice, Rule 31(b)(6) 4, 23

Statutes

California Civil Code, Sec. 1738(1) 3, 18

California Civil Code, Sec. 1738(2) 3

Internal Revenue Code of 1954, Sec. 351 .....28, 29

Internal Revenue Code of 1954, Sec. 351(a) 4, 28

Internal Revenue Code of 1954, Sec. 7442 4

Statutes of 1931, Ch. 1070, Sec. 1, p. 2240 3

United States Code, Title 26, Sec. 351(a) 4

United States Code, Title 26, Sec. 7442 4

United States Code, Title 26, Sec. 7482(a) 2

United States Code, Title 28, Sec. 1254(1) 2

IN THE

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No. .....

ADOLPH WEINBERG and ETTA WEINBERG,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled case on November 28, 1967.

Opinions Below

The opinion of the Court of Appeals, printed in Appendix A hereto, is reported in 386 F. 2d 836. The opinion of the Tax Court, printed in Appendix B hereto, is reported in 44 T.C. 233. The Report of Commissioner to The Chief Judge of the Tax Court of the United States is printed in Appendix C hereto.

Jurisdiction.

The judgment of the Court of Appeals, printed in Appendix D hereto, was entered on November 28, 1967. A due and timely Petition for Rehearing was denied on January 18, 1968. By Order Extending Time to File Petition for Writ of Certiorari dated March 31, 1968, the time for filing a petition for writ of certiorari was extended to and including May 4, 1968. The jurisdiction of this Court is invoked under 26 U.S.C. 7482-(a) and 28 U.S.C. 1254(1).

Questions Presented.

1. Whether the Court of Appeals failed to accord petitioners the correct standard of appellate review by the application of the "clearly erroneous rule" to the review of ultimate findings involving questions of law or mixed questions of fact and law and ultimate findings induced by a misapprehension of the correct principles of substantive law.

2. Whether the Tax Court erred in the application of the substantive rules of law of the State of California to determine whether petitioners transferred farm crops or cash proceeds to certain corporations.

3. Whether the Tax Court erred in considering as an issue whether farm crops had been transferred notwithstanding a statutory notice of deficiency and written stipulation stating that petitioners transferred farm crops to the corporations.

4. Whether the Tax Court erred in casting the burden of proof upon petitioners to establish that farm crops were transferred notwithstanding a notice of deficiency and written stipulation stating that petitioners transferred farm crops to the corporations.

5. Whether the Tax Court erred in its alternative determination which assumed that even if petitioners transferred farm crops to the corporations the income from their ultimate sale must be reported by petitioners on the legal theory that by the transfer of farm crops petitioners accomplished an anticipatory assignment of income already earned.

Statutes and Regulations Involved in the Case.

This case involves:

1. Section 1738 (1) and (2) of the Civil Code of the State of California (Statutes, 1931, ch. 1070, p. 2240, Section 1) which provides:

> Transfer of Property and Title
>
> § 1738. "PROPERTY IN SPECIFIC GOODS PASSES WHEN PARTIES SO INTEND. (1) Where there is a contract to sell specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.
>
> "(2) For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties, usages of trade and the circumstances of the case."

2. Section 351(a) of the Internal Revenue Code of 1954 (26 U.S.C. 351 (a)) printed in Appendix E hereto.

3. Tax Court Rules of Practice, Rule 31 (b)(1); Rule 31 (b)(4); and Rule 31 (b)(6), each printed in Appendix F hereto.

Concise Statement of the Case.

The initial proceeding was before the Tax Court of the United States for redetermination of statutory deficiencies in income tax. Jurisdiction in the Tax Court is conferred by Section 7442 of the Internal Revenue Code of 1954, 26 U.S.C. 7442.

The Commissioner of Internal Revenue ("Commissioner" hereinafter) addressed a notice of deficiency to petitioners Adolph Weinberg and Etta Weinberg ("petitioners" hereinafter), asserting an income tax liability (deficiency) for the calendar year 1955 in the amount of $316,348.02 and for the calendar year 1956 in the amount of $105,149.08. The notice of deficiency is printed in Appendix G hereto.

In the notice of deficiency the Commissioner determined for each of those years that the taxable income of the petitioners should be increased, and the deficiency assessed, by including the cash proceeds realized from the sale of farm crops which farm crops the petitioners had transferred to some fourteen corporations in which they owned all the capital stock. The Commissioner offered alternative explanations for the

adjustments. The first alternative was that the fourteen corporations were not recognizable for Federal tax purposes and that the income (cash proceeds from the sale of farm crops) should be reported by the petitioners, who grew the crops and controlled the corporations. The second alternative explanation was if it were determined that the fourteen corporations were tax-worthy entities, that inasmuch as the petitioners "performed all the services and incurred all the expenses attributable to the matured crops which were transferred to the fourteen corporations, the sales proceeds should be imputed" to the petitioners, "in order to clearly reflect income."

Trial was before a Commissioner designated by the Tax Court, who heard the case and filed his report of Findings of Fact printed in Appendix C hereto.

The Tax Court determined that the cash sales proceeds from the sale of the farm crops were includable in the income of petitioners on the ground that petitioners did not transfer farm crops to the fourteen corporations but rather sold the farm crops and then transferred the cash proceeds to the fourteen corporations. In the alternative, the Tax Court determined that even if petitioners transferred the farm crops to the fourteen corporations the transfer amounted to a transfer of earned income on the theory that it constituted an anticipatory assignment of income.

The essential factual findings of the Tax Court upon which the primary and alternative decisions were pred-

icated are set forth in the Opinion of the Tax Court entitled, "Findings of Fact". They are:

"During the taxable years and at all times here material petitioner was engaged in farming in the Imperial Valley, County of Imperial, California. Most of his farming operations during 1955 and 1956 were conducted through a partnership composed of himself and his wife and known as the Adolph and Etta Weinberg Partnership."

"Farming in Imperial Valley, as elsewhere, generally is a hazardous occupation depending on the weather conditions, the adaptability of the soil to different types of crops planted thereon, the extent of insect infestation, and other factors."

"In February 1955 petitioner had a conference with his accountants and attorney for the purpose of reviewing and reorganizing his business affairs. His health was not of the best and on his doctor's advice he was contemplating a trip of several months to Europe. It was decided at the conference that petitioner would turn over some of his farming business to a number of corporations to be organized for that purpose. Petitioner instructed his attorney to form the proposed corporations and stated that he would go to Imperial Valley and analyze the remaining unharvested fields and would transfer certain growing crops and $1,000 in cash to each of the corporations in exchange for all of its capital stock. Accordingly, articles of incorporation for the proposed corporations were prepared by the attorney and were filed with the Secretary of State of Cali-

fornia. Thereafter applications for the issuance of stock were filed by the corporations with the Commissioner of Corporations of the State of California and all of their stock was issued to petitioner either in the latter part of 1955 or early in 1956 as shown below."

"In the latter part of February 1955 petitioner made a survey of the Imperial Valley farms and informed the Holtville partnership and Bedwell [the growers of the farm crops] that he was going to transfer his interest in certain of the growing crops on the farms to the several corporations and that these crops were to be harvested and sold for the corporations and not for his personal account. He designated field-by-field which crops were to be transferred to each corporation. Thereafter the crops designated for transfer to the several corporations were harvested and sold and the proceeds of the sales were deposited in bank accounts in the name of the corporations."

"All parties concerned treated the produce or proceeds from its sale as the property of the several corporations which petitioner had designated to receive them."

"The produce which was to be shipped by rail was loaded on cars as it was harvested and when each car was sold, a jacket was placed on it designating the corporation for whose account it was harvested and sold as the seller and showing the contents of the car, the purchaser, and the selling price. Certain expenses relating to shipping the produce, such as brokerage and car refrigeration,

were paid by the corporations. These expenses were recorded in the separate accounts of the corporations and claimed as deductions in their income tax returns."

"The books and records of the Holtville partnership [one of the growers] were kept by one of the three partners, E.N.D. Hatch, who handled the partnership's sales of produce. Hatch first learned that petitioner was organizing the corporations in a telephone conversation with petitioner's accountant in late February 1955. He was told that petitioner's interest in the crops from certain farm lands had been assigned to the several corporations and that he would be furnished a list of the crops belonging to each corporation. Petitioner gave similar notice to Holly [the purchaser of the sugar beets]."

"The assigned crops were given a cost basis of zero both by petitioner and the corporations. The books and records and returns of neither petitioner nor the corporations show any gain or loss on petitioner's assignment of produce to the corporations or his receipt of the corporations' stock."

The stipulated facts are included herein by this reference. The stipulated facts include:

"A permit authorizing the issuance of stock was duly issued by the California Commissioner of Corporations on [various dates] pursuant to application [of each of the fourteen corporations] therefor and the stock was duly issued to Adolph [Weinberg] on [various dates] in exchange for said $1,000 cash and farm crops."

It was further stipulated as a fact that the following minutes of the first meeting of the board of directors are typical for each of the corporations showing actions taken:

"Minutes of First Meeting of Board of Directors of [each corporation]

"The President next brought up for discussion issuing of stock of the Corporation and after discussion upon motion duly made, seconded and unanimously carried it was resolved as follows:

"WHEREAS, Adolph Weinberg is willing to transfer certain agricultural products to the corporation in exchange for stock; and

"WHEREAS, the officers and directors are fully familiar with certain produce and know the market values and are certain that the Corporation can realize the funds it needs for its farming operations from said produce, now, therefore,

BE IT RESOLVED that the agricultural produce hereinafter described plus $1,000 in cash be received in exchange for the 100 shares of the no par value common stock of this Corporation and that the proper officer execute the necessary application to the Commissioner of Corporations of the State of California."

REASONS FOR GRANTING PETITION FOR WRIT OF CERTIORARI.

I.

The Court of Appeals Failed to Accord Petitioners the Proper Standard of Appellate Review and Thus Perpetuated the Errors of the Tax Court.

There are special and important reasons for granting a review on writ of certiorari. The first is that the Court of Appeals has failed to accord these petitioners the proper standard of appellate review by limiting their review solely to a determination of whether the Tax Court decision was clearly erroneous. Thereby the Court of Appeals failed to perform its duty to determine whether the Tax Court correctly applied the correct rules of substantive law to its own findings of fact. Petitioners have thus been assessed a deficiency of over $420,000 and have yet to have a proper review of the legal questions presented to the Court of Appeals.

The ultimate conclusion of the Tax Court, that the petitioners transferred cash proceeds from the sale of farm crops as distinguished from farm crops, is what petitioners attack as erroneous. The error was induced when the Tax Court, after trial of the issues presented by the statutory notice of deficiency and written stipulations wherein it was stated that farm crops were transferred, determined to disregard the notice of deficiency and written stipulation and concluded that the petitioners failed to establish that farm crops were transferred and that the only transfer was of cash proceeds from the sale of farm crops. The first error of

the Tax Court is in its disregard, after trial, of the notice of deficiency and stipulation which established the transfer of farm crops and its conclusion that the petitioners failed to meet the burden of proof to establish farm crops were transferred. The error is then compounded when the Tax Court failed to apply the settled substantive California law to the evidentiary facts found. Finally, the Tax Court, perhaps apprehensive of the validity of its ultimate conclusion, determined alternatively, and erred in its alternative conclusion, that even if farm crops were transferred, the result was correct because the transfer constituted an anticipatory assignment of income.

The failure of the Court of Appeals to accord petitioners the proper standard of appellate review has perpetuated the errors of the Tax Court. Only by the granting of this petition for review will these petitioners be accorded any review of the errors of the Tax Court which have been perpetuated by the summary disposition by the Court of Appeals.

The Court of Appeals resolved to affirm the decisions of the Tax Court on the sole ground that the Tax Court was not clearly wrong in determining that the taxpayer failed to establish that farm crops were transferred. Explicit in the opinion of the Court of Appeals is the declaration that the scope of the appellate review was confined to the "clearly erroneous rule" applicable to appellate review of the factual findings of the Tax Court. Thereby the Court of Appeals

departed from the standard of review applicable to review of ultimate findings and the review of such findings induced by a misapplication of the law by the Tax Court. *Davis v. Parkhill-Goodloe,* 302 F. 2d 489 (5th Cir. 1962).

> "Here the most critical aspect of that standard of review is that findings induced by or resulting from a misapprehension of controlling substantive principles lose the insulation of F. R. Civ. P. 52 (a) and a judgment based thereon cannot stand."

And in *Plomb Tool Co. v. Sanger,* 193 F. 2d 260 (9th Cir. 1951):

> "Nor is Rule 52 (a) Federal Rules of Civil Procedure, 28 USCA applicable to appellant's contention that Sanger was an independent contractor, for it is not the findings of the district court that appellant assails, but rather its conclusion drawn therefrom."

When the Court of Appeals concluded the Tax Court was not clearly wrong, it essentially confined its inquiry to whether there was sufficient evidentiary support for the factual findings of the Tax Court. This inquiry requires the appellate court to accept the Tax Court's determination of credibility or resolution of evidentiary conflicts. Thus, while an appellate court might draw another conclusion, it should not for that reason alone strike down the conclusion of the Tax Court because it is not, under those circumstances, clearly wrong. But this inquiry is not a part of the appellate review to be accorded questions of law or mixed questions of fact and law. The only way in which an appellate court can determine whether the trial court correctly apprehended

and applied the proper substantive legal principles is by reviewing the result. Effective review cannot be impeded by application of the clearly erroneous standard to the review of ultimate findings.

> "uniformity within a circuit or among circuits can be achieved only if appellate review of the application of a legal standard is free of the shackles of the 'unless clearly erroneous' rule." *Mamiye Bros. v. Barber Steamship Lines, Inc.*, 360 F. 2d 774 (2d Cir. 1966).

Where the standard of review has been misapprehended or misapplied, this Court should intervene. *Universal Camera Corporation v. National L.R. Bd.*, 340 U.S. 474, 95 L. Ed. 456, 71 S. Ct. 456.

A. The Tax Court Finding of the Ultimate Fact of Transfer of Cash Proceeds as Distinguished From Farm Crops Is Required to Be Reviewed Free From the Restraints of the "Clearly Erroneous Rule".

The Tax Court concluded that the petitioners did not transfer farm crops to the corporations but rather transferred cash. This was the ultimate finding as to the legal effect of the acts and utterances of the parties. This ultimate finding involving the application of legal principles is subject to review by this Court. *Baumgartner v. United States*, 322 U.S. 665, 64 S. Ct. 1240, 88 L. Ed. 1525.

Given the Tax Court's own findings of fact, where its conclusions were predicated upon an erroneous interpretation or application of the law of the State of California governing transfers of farm crops, this Court is reviewing a question of law as to whether the Tax Court applied the proper rule of law to the facts

found. *United States v. Singer Mfg. Co.*, 374 U.S. 174, 83 S. Ct. 1773, 10. L. Ed. 2d 823; *United States v. General Motors Corporation*, 384 U.S. 127, 16 L. Ed. 2d 415, 86 S. Ct. 1321.

The Tax Court erred in the application of the correct substantive rules of law in two instances. The first occurred in connection with the Tax Court's misapprehension of the law of the State of California governing transfers of farm crops. The second occurred in connection with the alternative conclusion of the Tax Court that even if the petitioner transferred farm crops the transaction constituted an anticipatory assignment of income and that accordingly the cash proceeds realized upon sale of the crops by the corporations to third persons, should be included in petitioners' income. This latter conclusion violates the basic rule that ownership is the basic test for determining who shall pay the tax. *Pearce v. Comm'r*, 315 U.S. 543, 554, 62 S. Ct. 754; *Blair v. Comm'r*, 300 U.S. 5, 57 S. Ct. 330, 333.

B. Whether the Petitioners Transferred Crops or Cash Is an Ultimate Finding Involving Questions of Law or Mixed Questions of Law and Fact.

Petitioners do not attack the facts found by the Tax Court but only the ultimate conclusion reached that the acts and utterances did not result in a transfer of farm crops but in a transfer of cash proceeds. Thus, as in *Simon v. Comm'r*, 285 F. 2d 422 (3d Cir. 1960):

> "In this court the petitioner does not assail the facts, largely stipulated, as found by the Tax Court,

but only its ultimate finding that a sale took place, asserting that 'there are no facts to support the Court's conclusion that a "sale", or any other kind of taxable disposition, took place.' The Tax Court's conclusion that the mortgage and subsequent conveyance to Exco was a sale is, of course, an ultimate finding of fact which this court can review free of the restraint imposed by the clearly erroneous rule applicable to ordinary findings of fact."

Also, in *Anderson v. Comm'r,* 78 F. 2d 636 (9th Cir. 1935), the ultimate question was whether the husband or wife was the owner of income-producing property. The question of ownership involved the effect, as measured by California law, of certain transactions between husband and wife. The court stated:

"Ownership is an ultimate fact, and the question here is ownership."

In *Brown v. Cowden Livestock,* 187 F. 2d 1015 (9th Cir. 1951), the court was concerned with the legal effect of certain transactions involving cattle and as to whether a sale resulted. There the court states:

"The findings of the District Judge in this regard are in effect findings as to the effect of these transactions rather than findings which involve disputed facts. Hence we do not find ourselves obstructed by the traditional rule not to disturb findings of fact of the trial court. We are therefore free to make our own determination as to the legal conclusion to be drawn."

The findings dealing with the effect of certain transactions or events is reviewable as a finding of law. *Stevenot v. Norberg,* 210 F. 2d 615 (9th Cir. 1954).

Where the facts involved in connection with the transaction are not in dispute, the question of when title passes becomes a question of law. *Lewis v. Farmers Grain & Milling Co.,* 52 Cal. App. 211, 198 Pac. 426 (1921).

> ". . . if as in this case the facts are not in dispute, it is a question of law for the court."

Thus, when the Tax Court found that petitioners, their business associates, the corporations which sold the crops to third persons, and the third persons who purchased the crops, all treated the crops and proceeds as belonging to the corporations, but notwithstanding this finding concluded that cash, not crops, was transferred, the appellate review must concern itself with the soundness of the legal conclusion that these actions operated to legally pass title in accordance with the laws of the State of California.

This ultimate conclusion requires no re-examination of the evidentiary facts, nor does it require an evaluation of the evidence in light of the fact finding tribunal's experience with the mainsprings of human conduct. The trial judge's experience with human affairs lead him to the factual conclusion that all parties involved in the transaction considered the crops and proceeds the property of the corporations. Upon the establishment of this fact, and the other facts as found, the question is presented as to the legal effect of these facts.

II.

The Law of the State of California Compels the Ultimate Finding That Farm Crops Were Transferred.

The transactions involving the crops took place in the State of California and therefore the determination as to the effect of the transactions, that is, whether they resulted in a transfer of farm crops or cash proceeds from their sale, is governed by the law of that State. *Pacific Grape Products Co. v. Comm'r*, 219 F. 2d 862 (9th Cir. 1955).

The substantive rules of law in California that measure the legal effect of the acts of the parties are:

Growing crops are proper subjects of absolute sale. In *Jones v. California Growers & Shippers*, 182 Cal. 777, 190 Pac. 172 (1920), the rule is:

> "Growing crops as well as other personal property are subject to absolute sale."

Thus, as stated in *Carey v. Glenco Citrus Products Co.*, 45 Cal. Rptr. 365, 235 Cal. App. 2d 727 (1965):

> "Under such a sale, title to the crop is transferred to the buyer at such time as the parties to the contract intend it to be transferred (Civil Code, § 1738), even though the crop is growing and has not matured."

Title to property passes in accordance with the intention of the parties. *Post v. Jacobsen*, 4 Cal. Rptr. 817, 180 Cal.App. 2d 297 (1960); *Nead v. Specimen Hill Mining Co.*, 52 Cal. App. 2d 475, 126 P. 2d

450 (1942). This rule is incorporated into California statutory law. California Civil Code, Section 1738, subdivision (1):

> "(1) Where there is a contract to sell specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred."

The facts found by the Tax Court include the finding that "He [Weinberg] designated field-by-field the crops which were to be transferred to each corporation."

The Tax Court also found that all parties concerned, petitioners, the corporations, the growers and the third persons to whom the crops were sold for cash, treated the crops and proceeds as the "property of the several corporations which petitioner had designated to receive them."

Also, "The produce which was to be shipped by rail was loaded on cars as it was harvested and when each car was sold, a jacket was placed on it designating the corporation for whose account it was harvested and sold as the seller and showing the contents of the car, the purchaser, and the selling price."

The Tax Court also states in its opinion that petitioners' intention was to transfer farm crops to the corporations.

Notwithstanding the detailed findings of fact, the Tax Court concluded that crops were not transferred to the corporations because "The only tangible evidence of any actual transfers to the corporations are the bills

of sale made out by petitioners to the corporations allegedly in part consideration for their stock." Later in the opinion the Tax Court reiterated by stating, "As stated above, the only tangible evidence of any transfers to the corporations are the bills of sale."

The Tax Court then reasoned that inasmuch as the bills of sale were actually prepared after harvest and sale of the crops they were of no significance and that the only transfers that occurred were transfers of cash proceeds and "These transfers occurred independently of the bills of sale, when, under petitioners direction, the proceeds from the sales were deposited in the corporations' bank accounts."

Petitioners agree that the execution of the bills of sale were not operative to transfer anything. They merely memorialized an event which had transpired.

The Tax Court obviously felt itself precluded from concluding that the crops were transferred because no "tangible evidence" such as a bill of sale was prepared and executed prior to harvest. But the law of California does not require the "tangible evidence" that the Tax Court required.

A tangible written bill of sale is not required to pass title. In *Lund v. Ganahl,* 22 Cal. App. 103, 133 Pac. 501 (1913), the rule is:

> "It is true that the price was not fully paid, and that no bill of sale passed between the parties . . . and it is well settled that it is not essential to the transfer of an interest in personal property that

> either of those two things should have been done; and when, as here, no different intention is manifested, the presumption is that title does pass without payment of the price or delivery of a bill of sale."

Nor does the law of California require such "tangible evidence" as delivery or payment. In *Hamilton v. Klinke,* 42 Cal. App. 426, 183 Pac. 675 (1919), the court states:

> "As between the parties a sale may be completed without either delivery or payment of consideration. That a sale may be consummated without delivery was decided in Johnson v. Dixon Farms Co., 29 C.A. 52, 155 P. 134."

The Tax Court concluded that the only transfer occurred when the cash proceeds were deposited in the corporations' bank accounts. The Tax Court equated the deposit to delivery and thus saw "tangible evidence" of a transfer and then reasoned that, inasmuch as there was no bill of sale executed prior to harvest, nor was there a physical delivery of the crops, the *only* tangible evidence of *any* transfer was that of the deposit of cash proceeds, thereby compelling the conclusion of ultimate fact that cash, not crops, was transferred. The Tax Court labored under the misapprehension that growing farm crops (or other personal property such as cash) cannot be transferred in California unless that transfer is evidenced by tangible evidence such as a bill of sale executed prior to transfer or manual delivery of the crops or cash.

The Tax Court did not use the words "tangible evidence" of transfer to mean "credible evidence" of transfer, nor did it equate "tangible evidence of any transfers" with an objective manifestation of transfer. The Tax Court on two occasions stated the "*only* tangible evidence" (emphasis ours) consisted of a document, a bill of sale. In so limiting "tangible evidence" to a document, the Tax Court could not have considered the objective manifestations of the parties as meeting the requirement of "tangible evidence." Thus, while the Tax Court found that:

> (1) petitioners designated field by field the crops which were to be transferred;
>
> (2) all parties treated the produce or the proceeds from sale as the property of the corporations; or
>
> (3) petitioner notified the growers and the buyers that he had assigned the crops to the corporations; and
>
> (4) as the produce was harvested, a jacket was placed on it designating the corporation for whose account it was harvested and sold; and
>
> (5) the expenses of selling the crops were paid by the corporations;

it concluded that none of these actions constituted any tangible evidence of a transfer of farm crops.

The Tax Court did not, in stating that the "only tangible evidence of transfer was the bill of sale, mean that the only objective manifestation of a transfer of crops was a bill of sale. There were ample objective manifestations of the intent of the parties which the Tax Court found. But these were not the "tangible evi-

dence" which the Tax Court required. Thus, the Tax Court equated tangible evidence to a physical bill of sale or delivery by deposit. The Tax Court excluded from its concept of "any tangible evidence" of transfer the objective manifestations of the parties as set forth in the detailed findings. Tangible evidence in the form of a physical bill of sale or delivery is not required by the law of the State of California.

In reviewing the rules of the common law regarding the passage of title, this Court, in *Hatch v. Standard Oil Company of Cleveland,* 100 U.S. 554, 25 L. Ed. 124, notes that "tangible evidence" of a transfer such as a writing, delivery or payment is not required, nor is it necessary that the property be in finished condition ready for delivery. The important factor is the indicated understanding of the parties.

In *Gensinger v. Comm'r,* 208 F. 2d 576 (9th Cir. 1953), the issue was whether a corporation had "distributed" crops to the sole shareholder. The court states:

> ". . . We turn, then, to the critical question whether the taxpayer 'distributed' the apricot and peach crops to himself as a shareholder. The fruit was personal property and no writing was necessary to transfer title to it. . . . In similar circumstances it has been held that any words or acts manifesting the person's intention to presently take title to the property in his individual capacity, or indicating that he considered the property his own is sufficient to establish that the transfer was made. In re Grant D.C.N.Y. 198 Fed. 708, 709, 710 affirmed without discussion of this point, Grant v. United States, 227 U.S. 74, 33 S.Ct. 190, 57 L.Ed. 423. "

III.

The Tax Court Erred in Concluding That Farm Crops Had Not Been Transferred When the Notice of Deficiency and a Stipulation Established That Farm Crops Were Transferred.

In the Commissioner's notice of deficiency (printed in Appendix G), addressed to petitioners, page 2, paragraph (a) 1 (b), under Explanation of Adjustment, the Commissioner stated that an adjustment was required by reason of the "matured farm crops which were transferred to the fourteen corporations." Nowhere in the notice did the Commissioner state or suggest that cash proceeds were transferred to the fourteen corporations.

Thereafter, in commencing preparation for trial of the issues, petitioners and the Commissioner entered into an extensive written stipulation as required by Rule 31 (b)(1) of the Tax Court Rules of Practice. The stipulation stated in part, "A permit authorizing the issuance of stock was duly issued by the California Commissioner of Corporations . . . pursuant to the application of [each corporation] therefor and the stock was duly issued to Adolph . . . in exchange for said $1,000 cash and farm crops." Such a stipulation is binding. *Weaver v. Comm'r,* 58 F. 2d 755 (9th Cir. 1932). Objections to a stipulation are required to be made in the stipulation or at the trial. [Tax Court Rules of Practice, Rule 31 (b)(4) and Rule 31 (b)(6).] No objection was made until after the trial when the Commissioner in his brief asked the Tax Court to disregard the stipulation. The Tax Court acceded, disregarded the stipulation and the notice of deficiency, and thereupon considered as an issue the question of whether farm crops or cash proceeds were transferred by petitioners to the corporations.

The basic error of the Tax Court was in considering an issue not raised in the Commissioner's notice of deficiency and which matter had been resolved by the stipulation. *Aubrey S. Nash,* 31 T.C. 569 (1958); *Vincent C. Campbell,* 11 T.C. 510 (1948).

The Tax Court should have addressed itself to the issues raised and tried, that is, whether the corporations were tax-worthy entities and whether the transfer of crops was an anticipatory assignment of income.

Trial was then had on the issues raised in the notice of deficiency. The Commissioner assigned by the Tax Court concluded the trial and filed his report. [Appendix F]

As was stated in *General Utilities & Operating Co. v. Helvering,* 296 U.S. 200, 56 S. Ct. 185:

> "Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

The Tax Court disregarded the stipulation and the notice of deficiency in determining that farm crops were not transferred. The Tax Court explained its disregard of the stipulation by stating the stipulation, even if construed literally, was erroneous and that the stipulation only "nominally" means that stock was issued for crops.

A literal construction of the stipulation requires no argument. The construction of written documents pre-

sents a question of law for review as to their meaning. *Cordovan Associates, Incorporated v. Dayton Rubber Company,* 290 F. 2d 858 (6th Cir. 1961); *Norfolk Nat'l Bank of C & T v. Comm'r,* 66 F. 2d 48 (4th Cir. 1933).

By the action of the Tax Court to disregard the notice of deficiency and the stipulation, petitioners have been effectively deprived of the opportunity to engage in trial of the issues and claims raised or determined thereby. Neither the "nominal" interpretation of the stipulation nor the resolution of the issue against petitioner by the Tax Court resolves the basic question of whether the petitioners were afforded a fair trial on the stated claims against them as defined in the notice of deficiency and stipulation.

It is this basic error which has deprived petitioners of a fair trial involving those issues which were raised in the notice of deficiency and the pleadings. Not only does such a basic error prejudice petitioners by injecting an issue for determination of which petitioners at or prior to trial were not advised, but it has, in this case particularly, wrongfully imposed the burden of proof on the issue. It is established that petitioners have the burden of disproving the correctness of the notice of deficency. The Tax Court concluded that, inasmuch as the "only tangible evidence of transfer" was certain bills of sale, petitioners had failed to establish that there was a transfer of farm crops. The Court of Appeals similarly concluded that petitioners

failed to establish a transfer of farm crops. The conclusion of the Tax Court, as well as that of the Court of Appeals, is predicated upon the duty of petitioners to establish the transfer of crops by a preponderance of the evidence. However, where the Commissioner departs from the grounds relied on in the notice of deficiency, he then has the burden of proof as to the issue. In *Thomas Wilson,* 25 T.C. 1058 (1956) the Tax Court states:

> "While a statutory notice of deficiency is presumed correct, and a petitioner has the burden of disproving its correctness, when the Commissioner departs from the grounds relied on in his deficiency notice to sustain a new theory later raised, he has the burden of proving any new matter raised. Sheldon Tauber, 24 T.C. 179."

The Tax Court, after trial, and the Court of Appeals cast upon petitioners the duty to establish the transfer of farm crops to the corporations. Prior to trial the Commissioner in the notice of deficiency had expressly recognized the transfer of farm crops but asserted the deficiency on the basis that the transferee corporations were not tax-worthy entities or, in the alternative, that the transfer constituted an anticipatory assignment of income. After the trial the Commissioner, in frank recognition of his previously stated position, requested the Tax Court to disregard the stipulation, thus admitting a clear departure from his previous position that farm crops were transferred. The burden of proof which petitioners assumed at the trial

was to disprove the correctness of the notice of deficiency. The Court of Appeals in affirming the determination of the Tax Court did so on the sole basis that the Tax Court was not clearly wrong in determining that petitioners failed to establish that farm crops were transferred. The duty to establish the transfer of farm crops was imposed after the trial. The Tax Court and the Court of Appeals thus mistakenly imposed the burden of proof upon petitioners.

In the case of *Fulton National Bank,* 363 F. 2d 562 (5th Cir. 1966):

> "If the trier of facts labored under such a serious legal misapprehension as to which party bore the burden of proof, its ultimate fact findings are not clothed with the insulation of Rule 52 (a) and may be disregarded by the appellate court."

The effect of the error of the Tax Court is a decision that petitioners failed to establish at the trial the very thing, transfer of farm crops, that was established by the notice of deficiency and the stipulation. This finding of the Tax Court, so induced, is free from the restraints of the "clearly erroneous rule" and should have been so reviewed by the Court of Appeals. It was not. The appellate review followed the same error, the opinion of the court stating the Tax Court decision was affirmed solely on the ground that the petitioners failed to establish the transfer of farm crops.

IV.

The Tax Court Erred in Its Alternative Decision That, Assuming That Farm Crops Were Transferred, the Petitioners Transferred Income Already Earned by Describing the Transaction as an Anticipatory Assignment of Income.

This argument is addressed to the Tax Court's alternative determination that, accepting the ultimate fact of transfer of farm crops to the corporations, the transfer was a transfer of "earned income," taxable to petitioners, by labeling the transfer of the farm crops as an anticipatory assignment of income.

Petitioners transferred farm crops to the several corporations during the calendar year 1955 in a transaction pursuant to and precisely within the terms of Section 351 of the Internal Revenue Code of 1954, which by the terms of that section resulted in the nonrecognition of gain or loss to petitioners. Further, during the calendar year 1956, petitioners contributed farm crops to several of the corporations as a contribution to capital, likewise, a transaction which resulted in the nonrecognition of gain or loss to petitioners.

Section 351(a) of the Internal Revenue Code of 1954, provides in part:

> ". . . No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control . . . of the corporation . . ."

Section 351 of the Internal Revenue Code of 1954, dates from the Revenue Act of 1921. Under previous

revenue acts, the creation of even a one-man corporation by the transfer of appreciated or depreciated property for its entire capital stock was an occasion on which gain or loss was recognized by the transferor. Since 1921, however, gain or loss has not been recognized on such a transaction. The basic premise of Section 351 is that a transfer of appreciated or depreciated property to a corporation that is controlled by the transferor works a change of form only, which should not be an occasion for reckoning up the transferor's gain or loss on the transferred property. See *Portland Oil Co. v. Comm'r,* 109 F. 2d 479, 488 (1st Cir. 1940), *cert. den.* 310 U.S. 650, 60 S. Ct. 1100. A capital contribution by a sole stockholder to the corporation represents a transfer for full and adequate consideration, *Heringer v. Comm'r,* 235 F. 2d 149 (9th Cir. 1956), and represents an additional price paid for the shares of stock held by the individual shareholder. Treas. Reg. (1954 Code) ¶ 1.118-1.

Since the transfers of the farm crops by petitioners were pursuant to transactions under which neither gain nor loss was recognized by petitioners, upon the subsequent sale of the farm crops by the transferee corporations, the income therefrom was taxable to the transferee corporations and not to petitioners.

The Tax Court, however, determined that since practically all of the services contributing to the production of the income from the sale of the farm crops were performed by petitioners such income was all earned by petitioners and therefore the transfers of the farm crops were of income already earned.

This determination of the Tax Court is erroneous in law. Where income is derived from property, the basic

test for determining who is to bear the tax is that of ownership. *Pearce v. Comm'r* (1942), 315 U.S. 543, 554, 62 S. Ct. 754, 760; *Blair v. Comm'r* (1937), 300 U.S. 5, 12, 57 S. Ct. 330, 333.

Pearce v. Comm'r, involved an annuity contract purchased by the divorced husband for the divorced wife pursuant to their agreement made prior to the divorce. The question presented was whether the income arising from the annuity subsequent to the divorce decree was taxable to the wife who received it or to the husband who provided it. In holding that the income was taxable to the wife, the Supreme Court said (315 U.S. at p. 554):

> ". . . Such cases as Helvering v. Horst, 311 U.S. 112, . . . Helvering v. Eubank, 311 U.S. 122, . . . and Harrison v. Schaffner, supra, are not opposed to this result. Those cases dealt with situations where the taxpayer had made assignments of income from property. He was held taxable on the income assigned by reason of the principle 'that the power to dispose of income is the equivalent of ownership of it and that the exercise of the power to procure its payment to another, whether to pay a debt or to make a gift, is within the reach' of the federal income tax law. Harrison v. Schaffner, supra, 312 U.S. 580, . . . But in those cases the donor or grantor had 'parted with no substantial interest in property other than the specified payments of income' . . . Here he had parted with the corpus. And 'the tax is upon income as to which' in the general application of the revenue acts, the tax liability attaches to ownership.' Blair v. Comm'r, 300 U.S. 5, 12, 57 S. Ct. 330, 333, 81 L. Ed. 465. . . ."

As in the *Pearce* case and the *Blair* case, the tax here is not upon earnings which are taxed to the one who earns them. In the instant case, the tax is upon income as to which, in the general application of the revenue acts, the tax liability attaches to ownership, that is, to the several corporations who owned and then sold the farm crops. To the time that petitioners transferred the farm crops, no income had been received by or accrued to them with respect to the farm crops. At most, the farm crops represented property being held by petitioners for future disposition or utilization.

A transfer of farm crops, either harvested or unharvested, pursuant to a transaction under which the Internal Revenue Code provides for nonrecognition of gain or loss does not constitute a transfer of "income already earned", but rather merely constitutes a transfer of property which has appreciated in value and upon the subsequent sale of the farm crops by the transferee the income from the sale will not be taxed to the transferor, but rather the income will be taxed to the transferee. This is so because farm crops, either harvested or unharvested, merely represent property being held for future disposition or utilization and do not represent taxable income either earned, realized, received, or accrued.[1] *Comm'r v. South Lake Farms, Inc.*, 324 F. 2d 837 (9th Cir. 1963); *United States v. Horschel*,

[1]The Tax Court has so held on more than one occasion. *Ralph Romine*, 25 T.C. 859 at 876 (1956), transfer of harvested corn; *Elsie Sorelle*, 22 T.C. 459 (1954), transfer of mature crops of wheat immediately prior to harvest; *Catharine G. Shatzer*, 3 T.C. 914 (1944), transfer of farm chattels; *Estate of Tom L. Burnet*, 2 T.C. 89 (1943); *Louisiana Irrigation & Mill Co.*, 14 T.C.M. 1252, T.C. Memo. 1955-320, transfer of harvested rice; *cf. Stuart A. Rodgers*, 38 T.C. 785 (1962), transfer of timber.

205 F. 2d 646 (9th Cir. 1953); *White v. Brodrick,* 104 F. Supp. 213 (D.C.D., 1952) appeal dismissed 198 F. 2d 751; *cf. Campbell v. Prothro,* 209 F. 2d 331 (5th Cir. 1954) and *Gensinger v. Comm'r,* 208 F. 2d 576 (9th Cir. 1953).

The Court in *Comm'r v. South Lake Farms, Inc., supra,* held that a transfer of growing crops by one corporation to another in a nontaxable liquidation did not result in any gain to the transferor. At the time of the liquidation of the transferor on October 3, the cotton crop had not completely matured and harvesting by the transferee of the cotton crop commenced on October 4, and the Court said (324 F. 2d at p. 838):

> ". . . Under the published rulings of the Commissioner, not all of the events which fix the right to receive the income from the crops had occurred by the time of liquidation. (See Treas. Reg. (1954 Code) ¶ 1.446-1 (c) (1) (ii)) . . .
>
> ". . . None of the cases on which the Commissioner relies is in point. In most of them the liquidation of a corporation which was on a cash basis occurred at a time when income was fully earned, and the Commissioner, in order truly to reflect income, required that the corporation accrue these items in the year of dissolution . . ."

and at page 839:

> ". . . Here, on the other hand, no income had been earned at the time of the dissolution, and the growing cotton crops, which were harvested thereafter over a period of two and a half months, cannot fairly be said to represent accrued or accruable income . . ."

Likewise, in the instant case, no income had been earned at the time of the transfers by petitioners.

In *United States v. Horschel,*[2] *supra,* a corporation which kept its books and reported its income on a calendar year and on a cash basis, dissolved and conveyed, among other things, to the stockholders, apples in a warehouse "pool" and certain supplies with a tax basis of zero which the stockholders sold and received the proceeds therefrom, and the Court squarely held that the transfer of the apples to the transferees was not an anticipatory assignment of income taxable to the transferor, saying (205 F. 2d at p. 647):

> "The sole question presented on this appeal is whether part of the distribution of assets made by a corporation upon its liquidation constituted an assignment of anticipated income taxable to it . . ."

Practically all of the services contributing to the production of the income were performed by the corporation. The Ninth Circuit Court of Appeals in holding that the proceeds from the sales of the foregoing apples and supplies were not taxable to the corporation stated that the principle of anticipatory assignment of income was not applicable and so stated (205 F. 2d at p. 648):

> ". . . The supplies were disposed of for cash more than four months after the corporation was out

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[2]In *Hersloff, et al. v. U.S.*, 310 F. 2d 947 (Ct. Cl.-1962), the Court noted: "The [Horschel case] turned on the Government's attempt to tax certain income to the [corporation] on the ground that the prior distribution of the assets had amounted to an anticipatory assignment of income already earned by the [corporation]." The *Horschel* case was also noted in *Wellhouse, Jr.,*

(This footnote is continued on the next page)

> of existence. The apples had been packed and placed in a warehouse pool and were sold for cash from time to time during the eleven months following dissolution. These apples could no more be considered cash at the time of dissolution than could be the ranch which produced them . . ."

And at page 649:

> ". . . The principle of anticipatory assignment of income is not applicable in this case . . .
>
> ". . . and the income was properly reported by the owners of the property that earned it, viz. the distributee shareholders. See Blair v. Commissioner, 1937, 300 U.S. 5, 57 S.Ct. 330, 81 L. Ed. 465 . . ."

The same result was reached in *Gensinger v. Comm'r*, 208 F. 2d 576 (9th Cir. 1953), where a corporation liquidated and distributed to its shareholder apricots and peaches, which crops were sold by the shareholder. Practically all of the services contributing to the production of income were performed by the corporation and the principal question before the Ninth Circuit Court of Appeals was whether the proceeds of the sales of the apricots and peaches were income of the transferor corporation, and the Court held, no.

In *White v. Brodrick, supra*, during the taxable year 1947, the taxpayer donated bushels of wheat to a charitable organization in a nontaxable transaction

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et al. v. Tomlinson, 197 F. Supp. 739 (D.C. So. Dist. Fla.-1961), as an example of the rule that if income producing property is assigned, the income therefrom is not taxable to the assignor.

and deducted on his 1947 income tax return as a charitable contribution the fair market value of the wheat. The wheat donated by the taxpayer was planted in 1946, was harvested and stored in 1947, and was thereafter held by the taxpayer for sale in the ordinary course of his farming business. Practically all of the services contributing to the production of income were performed by the taxpayer. The Commissioner determined that the gross income of the taxpayer should be increased by an amount representing the fair market value of the wheat donated. The Court concluded that the taxpayer did not realize taxable income or gain by reason of the donation and disposition of the wheat and that the Commissioner erred in holding that the fair market value of the wheat donated and disposed of was taxable income to the taxpayer.

Conclusion.

Petitioners respectfully submit that this Court, by application of the substantive law of the State of California to the factual findings of the Tax Court, should determine that the Tax Court erred in its determination of the ultimate fact and that, by application of the substantive law of California, petitioners transferred farm crops to the corporations rather than cash proceeds from their ultimate sale. Further, that this Court should determine that the Tax Court erred in its alternative decision that the transfer of farm crops constituted a transfer of income already earned and that the proceeds from the sale of the crops by the

corporations is properly reportable by the corporations because they were the owners of the crops at the time of sale. The Tax Court did not make findings of fact or draw conclusions of law on the issue of whether the corporations were tax-worthy entities or whether the several corporations were entitled to a single surtax exemption.

Respectfully submitted,

DEMETRIOU & DEL GUERCIO,
RICHARD A. DEL GUERCIO,
RONALD J. DEL GUERCIO,
Attorneys for Petitioners.